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## Securitisation and Bankruptcy in Indonesia: Theme and Variations

by Paul H. Brietzke,\* May 29, 1999

This article describes works very much in progress: efforts to implement a few of the economic laws that match Indonesia's huge economic potential. From the perspective of a potential creditor, there is a conflict between secured transactions laws and bankruptcy laws which appears to exist worldwide. This conflict is particularly severe in Indonesia, a disturbing facet of the current Crisis. If the reader can tolerate it, I will use a bit of economics to gloss the securitisation-and-bankruptcy theme, before moving on to Indonesian variations that will be of more interest.

### *The Theme*

Along with technology perhaps, capital is the scarcest resource for purposes of growth and development, in Indonesia and most other countries. Equity markets are typically underdeveloped sources for this capital, in comparison with the huge sums needed, so the need arises to maximize sources of debt finance. Creditors who provide capital through this debt finance are searching for the lowest risk/return ratio they can find anywhere in the world, to maximize the value of funds they have available to lend. (n. 1) Law can do little to affect the creditor's expected rate of return, which is ultimately based on the profitability of the use to which the capital is put. But law can do much to reduce the creditor's perceived risks: that the loan will not be repaid, in full and on time. Law should make the creditor feel as *secure* as possible, by giving it an interest in the debtor's valuable assets that can be enforced if the loan is not repaid. In competitive credit markets at least, secure creditors will lend more money (capital), at lower rates of interest which reflect a lower risk. Lower interest rates mean lower costs of production, which makes the debtors' goods and services cheaper, more competitive.

Ideally, secured transactions laws reduce the creditor's risks, and thus reduce the risk premium (part of the interest rate) the debtor pays, by reducing the transaction costs (n.2) of the creditor acquiring a security (property) interest in the debtor's valuable assets, and of enforcing this interest if the loan is not repaid. Such laws trust the *solvent* debtor to look after its own interests, requiring only that, for example, the debtor's written consent be displayed for certain matters. The isolated contract between this debtor and this creditor gets enforced more or less as it is written: to keep transaction costs low by simply recognizing what amounts to the creditor's contract of adhesion, out of respect for the debtor's autonomy, and in the hope that competition among creditors for the debtor's business will lead to terms being offered which are fair as well as efficient. The terms of the agreement are not examined by courts in any detail because the presumption *in a competitive credit market* is

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that terms, which may seem harsh on the debtor, reflect the fact that the debtor got a lower interest rate or that the creditor expects a particular debtor or transaction to involve a higher risk.

Perhaps needless to say, bankruptcy laws have different purposes and effects. The law becomes quite paternalistic towards the debtor, and having liabilities in excess of one's assets does admittedly limit your economic (as opposed to existential) autonomy. But even more important from the economics standpoint is that the law does not, indeed cannot, treat each creditor in isolation from the others. Rather, bankruptcy law reduces particular kinds of transaction costs: coordination costs associated with the following "collective action problem." Assume, as bankruptcy lawyers tend to do, that the value of the debtor's firm reorganized in bankruptcy, or even of running it for a time prior to liquidation, exceeds the value of immediately dismembering the debtor (a serious step, the corporate death penalty) *to creditors as a class*. (In reality, the law treats classes of secured and unsecured creditors.) Absent a bankruptcy law moratorium, the other creditors cannot stop an isolated creditor from exercising its rights under the secured transactions law. This was a good thing in the previous, non-bankruptcy paragraph, but it goes bad when the secured creditor seizes and sells crucial assets. If this forces the debtor to close up shop, it also forces other creditors to forego gains from the debtor's business continuing somehow. (Bandhari & Weiss, 1996).

Ronald Coase won the Nobel Prize in Economics by (in effect) showing how, in his (weird) world of zero transaction costs, the other creditors who benefit from a continuation of the debtor's business would bribe the isolated creditor not to exercise its legal right to seize and sell. But the transaction costs of coordinating these beneficiaries (that is, costs of determining and enforcing who is to pay what part of the bribe) are so high in the real world that the isolated creditor can act as a Coasian "free rider." In other words, the isolated creditor can benefit itself, at the expense of reducing the wealth of other creditors, unless something like a bankruptcy moratorium is used to maximize the wealth of the group as a whole. (See Brietzke, 1999). The legal "technology" used here is *not* that of a secured transactions law: enforce the isolated debt contract more or less as written. Rather, bankruptcy law enforces what some experts see as a hypothetical contract: the kind of bargain creditors who are uncertain about their place in any future bankruptcy proceeding would enter into, were transaction costs not so high. (Bandhari & Weiss, 1996, 26). As Elizabeth Warren puts it (in Mandel and Foust, 1998): "Bankruptcy is a way to say to creditors, 'Get real. The money's not there.'"

What effect does all of this have on the *potential* creditor who has not yet lent money, the perspective I asked us to adopt? The answer is important to Indonesia, and it tends to prove out an old adage: "Where you stand depends on where you sit." This potential creditor would like the outcome if it expects to be one of the group of creditors during bankruptcy, but not if it expects to be the isolated creditor. Having taken the trouble to perfect a security interest under the secured transactions law, the isolated creditor then loses the opportunity to be a Coasian free rider under the bankruptcy law. Rather, this isolated and fully secured creditor must make concessions (Coasian bribes, *infra*) to other creditors, to gain their consent to the termination of expensive bankruptcy proceedings. (Bandhari & Weiss, 1996, 109). Correspondingly, if our potential creditor expects to be part of the group of creditors, it can expect the opportunity to receive such a bribe.

I argue that our potential creditor expects to be the isolated, fully secured creditor (rather than part of the creditor group), since it is willing to bear the initial expense of perfecting a

security interest under the secured transactions law. The potential creditor would then regard loss of the opportunity to be a Coasian free rider as increasing the risk that it will not be paid in full. This higher expected risk means that, with the expected return remaining the same, our potential creditor will lend less money and at a higher interest rate. If the potential creditor expects any difficulties in enforcing its reduced rights, through the courts during a bankruptcy proceeding, expected risks will increase markedly. A loan agreement which is viable from the debtor's standpoint then becomes much less likely: bankruptcy law taketh away what the secured transactions law giveth.

### *Variation 1: 1906/1998 Bankruptcy*

Indonesia's Bankruptcy Law (No. 4 of 1998) unevenly amends rather than repeals the 1906 Bankruptcy Law. Veronica Taylor (1999) notes that such a quick fix causes slow problems, worldwide. Problems arising from the language and the judicial enforcement of this amalgam are familiar, and will thus be treated briefly. Archaic anomalies in the 1906 Law (n. 3) appear to survive and to hinder effective reorganization of firms, and adequate protection of secured creditors, late in the Twentieth Century. The law addresses individuals and their estates almost exclusively, and the Orphans' Chamber retains much potential control over the process: *see, e.g.*, 1998, Art. 13(2), 67A and 1906, Art. 26-27, 48, 68, 109. This body has a reputation for venality and pettifogging delay akin to that of the Doctors' Commons in Dickens' *David Copperfield*.

Article 34 of the 1906 Law poses an interpretive puzzle which may inhere in translation, from Dutch to Indonesian or from Indonesian to English: "The ownership registration..., the establishment of a mortgage [hypotec]...[, or] a mortgage [hypotec] on the harvest, may not be legally effected after a bankruptcy declaration." It *seems* like bankruptcy wholly overrides the interests of creditors secured by these means, and this is clarified only a bit by Articles 56A and 56(1) of the 1998 Bankruptcy Law. The latter more broadly provides that, subject to the former, a holder of "security rights, pledge or collateral right...may execute his rights as if no bankruptcy occurred." The former defers this execution right for up to 90 days, although secured creditors can petition the Supervising Judge to remove this moratorium. Given the rate at which Indonesian courts typically move, this petition-opportunity is of little value. Rather, the strategic use of the courts to delay this process (*infra*) will mean that our potential creditor can expect many more than 90 days to pass, before it *may* be able to realize its collateral under Article 56(1) rather than Article 34. Our potential creditor is unlikely to feel very secure thus far in the analysis, and worse is to come.

A creditors' meeting or meetings will be held during bankruptcy, and votes require approval by more than half of the creditors. The weighting of creditors' voting rights will be stipulated by subsequent Regulation (1998, Art. 77A, 78.) The apparently separate Creditors' Committee that may be formed under Article 72, or the Supervising Judge in default, may decide to continue the bankrupt's business for an indefinite period (1998, Art. 95; two slightly different versions may be in effect). Any creditor can also propose that the debtor's business be continued; the creditors' meeting is then postponed, and decisions can be appealed to a court: 1906, Art. 168A. After complex adjustments of competing claims ("verification"), with abundant opportunities for time-consuming challenges and court appeals by ostensibly dissatisfied creditors (Art. 104-33, mostly from 1906; *see* Art. 179-80 and *infra*), the creditors' meeting votes on the reconciliation proposal. The proposal is accepted if more than half of the unsecured creditors, accounting for at least two-thirds of unsecured claims, vote for it (1998, Art. 141). This is apparently in addition to the

requirement that at least half of all creditors vote for it (Art. 77A, *supra*). Our potential creditor must be concerned: the creditors' and Committee meetings offer abundant opportunities for individuals and the group to engage in "strategic behavior" that delays and perhaps defeats the potential creditor's expected ability to realize its collateral.

There are other opportunities for delay, too. (*But see* Linnan, 1999.) As you might expect, final decisions from the Commercial Court may be appealed to the Supreme Court within six months, if there is important new written evidence or a "serious error" was made in law (1998, Art. 286-87). But reference is also made to the applicability of Articles 8-11, at several potentially contentious junctures of the 1998 Law. Article 8(1) permits appeal to the Supreme Court of a "legal action regarding a petition for bankruptcy." On its face, this permits the debtor or a single (ostensibly disgruntled) creditor to appeal almost anything. Like the meetings sketched in the previous paragraph, Article 8(1) confers the opportunity to act like a Coasian holdout: to defeat or delay the payout of money that our potential creditor would like to reinvest, unless the holdout's consent is procured through a Coasian bribe. This bribe would likely take the form of a payment from the subsequent sale of collateral held by an ostensibly-secured creditor. *See also* 1906, Articles 179-82: any creditor can challenge the "distribution list"; the examining magistrate will decide after a public hearing; and appeal lies to the Supreme Court.

Provisions for a debtor's voluntary bankruptcy (moratorium on repayment) are generally similar, although the moratorium may extend for up to nine months (1998; *compare* Art. 217(4) *with* Art. 231A). Perhaps needless to say, tendencies like those described here exist in all bankruptcy laws to some degree. It is their extent and virulence in Indonesia that attracts our attention, and that of potential creditors.

Our potential creditor's expectations of bankruptcy are of not being a free rider, while having to bribe many holdouts during a moratorium which is likely to be prolonged. This markedly increases our creditor's risks and transaction costs, so that less money will be lent to Indonesians and at higher interest rates. Such analyses are necessarily hypothetical, since very few real-world secured creditors have gotten this far. Only about fifty cases have been filed under the 1998 amendments, as opposed to the flood of cases that was expected, and less than one-third of these cases have led to bankruptcy: Webb, 1999.

Instead of heeding Elizabeth Warren's advice (*supra*), secured creditors are perhaps waiting to evaluate outcomes under the Jakarta Initiative (*infra*) or waiting for a more favorable judicial or macroeconomic climate. But Kartini Muljadi reports, in "Commercial", 1999, that 55% of bankruptcy cases have been "settled." In any event, no foreign creditor has yet prevailed (realized its collateral) through the courts, against a pribumi debtor. For David Linnan (1999), this may reflect an economic nationalism. The Commercial and Supreme Courts are reported in the media as giving various reasons for this state of affairs, but Charles Himawan (1998) was led to ask: "Bankruptcy law or bankruptcy of law?" For Timothy De Sieno (1999), the law is "plagued by substantive inadequacies, vagaries", "procedural delays", "stigma and inherent uncertainties", and "less than optimal commercial results." Sara Webb (1999) finds that this lynchpin of Crisis recovery is "slow to force bankers and companies to sort out bad debts."

#### *Variation 2: Fidusia Registration Draft (n. 4)*

Creditors who would like to be secure in Indonesia have operated under twin legal handicaps: the absence of a registry for their security interests in the debtors' movables and intangibles (apparently and suprisingly like Hong Kong in this regard), and the need to cast their interests into awkward legal molds. The creation of a Registry under the Draft Law will reduce

creditors' risks and transaction costs significantly. In the past, Indonesian debtors could (and reportedly did) use the same property to secure several loans from several different creditors (Mochtar, 1991, 151). Subsequent creditors could not discover prior claims on the property by consulting a registry. When loans went unpaid, as under Variation 1, *supra*, creditors would struggle to divide a pie that was much too small by the debtor's design. This sometimes led to self-help measures, which were reportedly tests of the creditors' relative power positions.

Under the Draft Law, the creditor's security (and priority-ranking) is "born" on the day registration is proved, although there is a sixty-day transition period for registering pre-existing fidusia. While the Registrar has no discretion to deny registration, an anti-corruption measure in part, the standardized registration form must be prepared by a notary. (See Draft Art. 13-14, 35.) This is consistent with civil law conventions, but it confers another opportunity for notaries to obtain the economists' "rents" and thus increase transaction costs from the creditors' perspective. Civilians might argue that the presence of a notary in the paper chain also decreases the creditor's risks. But if a particular creditor trusts a particular notary rather than some other legal professional, who is already employed to prepare the documentation, that notary will be employed without requiring it under law.

It is hoped that transaction (information) costs will be reduced further by developing a computerized Registry to facilitate searches, on an Internet site accessible worldwide and cross-indexed with companies, securities, bankruptcy, perhaps land, etc. filings. "One-stop" information shopping would enhance transparency and promote investments of various kinds in Indonesia.

Early in the drafting process, registration of the kinds of secured transactions widely used in international finance was considered. But this was thought impossible by the wider (interdepartmental) drafting team. For the present at least, only devices previously used by Indonesian lawyers will continue to be used: fidusia (fiduciary transfers and assignments) and (unregistered) pledges. Pledges are nearly useless for modern business purposes: the creditor (typically) takes possession of the property. The debtor thus cannot use the property for productive purposes, purposes which increase the likelihood that the loan will be repaid. Fiduciary transfers and assignments reflect a civilians' conceptual aversion to non-possessory security interests: see Cranston, 1995, \_\_\_\_\_. These fidusia exist only by virtue of approval in a 1932 Dutch Supreme Court decision (and a Netherlands East Indies Court decision in 1936). While this would be of some (precedential) value in a common law jurisdiction, it is of almost no value in a traditional civil law jurisdiction that maintains sources of legal authority in a strict hierarchy.

Perhaps needless to say, Independence and an era of "revolutionary interpretations" cast further doubt on fidusia. But they have a "real" existence in the conventions of the Indonesian practitioners who draft them, especially as fidusia have not been (fully) challenged in modern Indonesian courts. The uncertain contours and legal status of fidusia increase creditors' risks and transaction costs in Indonesia, and seemingly make practitioners reluctant to use fidusia to secure property and/or transactions unknown in Holland, early in the Twentieth Century. This is less a creditor's contract of adhesion than a notary's contract of adhesion. (See generally Mochtar, 1991, 150-53.)

Indonesian businesses are severely handicapped by fidusia practices, even if fidusia are now to be registered: being able to offer fewer types of property for security in fewer ways means

(once again) less capital being lent to Indonesians, and at higher interest rates. Some creditors (at least) are bound to regard this as a legal “mess” (more politely, very high risks, legal information costs, and rents for the few practitioners able to command this information adequately), and to resolve their uncertainties by lending their money in some other country. Indonesia would arguably be served by fully stipulating fidusia in more modernizing ways, and by also registering and enforcing “international standard” secured transactions that do not require creditors totally to recalculate their legal risks.

### *Variation 3: Bankruptcy Draft Amendments*

While Government plans to amend the Bankruptcy Law (“Indonesia Amending...,” 1999), draft amendments were unavailable to the author as of this writing. Amendments are unlikely to make major changes, and will likely be restricted to attempts to overrule Commercial and Supreme Court decisions seen as inconsistent with the Law’s purposes. Daniel Lev (1999) would see this as keeping colonial law as intact as possible, since lawyers and (other) leaders are familiar with its contours. But David Linnan (1999) wants the new law to strengthen voluntary reorganizations (*but see supra*), to promote debt-equity swaps, and to offer more of a “threat.” Liquidation is currently not much of a threat: creditors and debtors don’t want it, and creditors don’t want to run the company themselves (Linnan, 1999).

Government will also appoint legal academics and practitioners to sit as Commercial Court Judges (“Govt”, 1999), a “court-packing plan” that may signal Government’s displeasure with what some see as a willful misreading of existing laws. Greg Churchill (1999) sees a “jurisprudence of confusion” in the courts over bankruptcy, and Kartini Muljadi (in “Commercial”, 1999; *see Webb*, 1999) sees the Court’s inability to understand the complex structure and terminology of international finance as “one of the impediments to establishing a predictable and just insolvency regime.” Thomson BankWatch adds (in “Govt”, 1999) that: “Recent rulings ...have gone in favor of debtors, which could diminish the incentive for distressed corporations to restructure their obligations.” Government is also reported to be contemplating a reorganization draft law, perhaps to give bankruptcy more of a modern business orientation, to dovetail with Articles 114-24 of the Company Law (No. 1 of 1995), and/or to give the Jakarta Initiative a legal form: *see Purba*, 1999.

### *Variation 4: The Jakarta Initiative*

This Initiative fits into our “Theme” by creating a solution to the “collective action problem” (*supra*) which rivals and arguably detracts from the one created under Variation 1: the 1906/1998 Bankruptcy rules. The Jakarta Initiative is the micro equivalent of World Bank/IMF macroeconomic policies: declarations that Indonesia is in such deep trouble that chaos can be avoided only through cooperative solutions. (*See Mandel and Foust*, 1998; *but see also* “Indonesia’s”, 1999.) The Initiative is “legally non-binding”, and circumvents the courts and bankruptcy procedures through a negotiated but “reasonable and finite” moratorium (WB/IMF, 1998; “Indonesia’s”, 1999). The idea is to add value to non-performing loans, and to reduce the cost of IBRA (*infra*) to taxpayers. Creditors’ claims will be voluntarily subordinated to any new funds advanced, and the company proposes a corporate and debt restructuring plan that forms the basis for negotiations with creditors (*ibid.*).

The recovery of debts and restructuring of assets will depend on the success of IBRA's complementary Asset Management Unit, which seeks to re-create domestic banks capable of making loans on a commercial basis: *see* Law No. 10 of 1998, Article 37A, amending the Law Regarding Banking, No. 7 of 1992, and Regulation Regarding the Indonesian Bank Restructuring Agency, No. 17 of 1999, Art. 2(4), attesting to IBRA's *lex specialis* authority for the next five years. An unidentified commentator calls IBRA the "largest nationalization in Indonesia's history." Whether and to what extent 'compensation' will be paid for this 'nationalization', especially to private companies whose joint ventures are caught in IBRA's coils, remains to be seen, but it is rumored that Indonesian courts will take a dim view of IBRA's extraordinary powers. Government has promised the removal of tax, regulatory and other legal (perhaps bankruptcy) impediments, under a "one-stop shopping" that would reduce transaction costs and thus increase the likelihood of agreement between debtors and creditors.

The Initiative detracts from bankruptcy by *promising* benefits which cannot be matched through bankruptcy processes: a longer debt rescheduling, up to eight years under the June 1998 Frankfurt Agreement; perhaps a greater forgiveness of debts and more debt-for-equity swaps; regulatory relief and the ability to stay out of the Orphan's Chamber and the Commercial Court; and the *possibility* of new debt finance by foreign creditors and even international donors ("Indonesia's", 1999; "Kadin", 1998). Despite these benefits, only twenty companies (accounting for \$2.7 billion in debt) have reportedly been "helped" to some extent by the Initiative since it was launched in November 1998, and one hundred companies are thinking of joining in: "*see Indonesia's*", 1999. This is a small percentage of the 2,000 eligible (debt-ridden) companies: *see* "Kadin", 1998; *but see* De Sieno, 1999.

Despite promised benefits, the Initiative has seemingly failed to date, in that a debt restructuring standoff continues to delay Indonesia's economic recovery. Debtors remain reluctant to acknowledge their obligations, and creditors are still unwilling to write off part of the debt or to accept equity in exchange for debt. (McCarthy, 1999; Solomon, 1999.) *See also* "P T Astra", 1999 (an excellent example of debt negotiations through the media), stating that Indonesian debt trades at heavy discounts in secondary markets, in hopes that restructuring will increase returns on an investment in debt.) Stock prices are so low that shares amount to little more than options, which give shareholders little incentive to do more than hang on and see what happens: Linnan, 1999.

Elizabeth Warren's advice (*supra*) is not being heeded. Like other state-sponsored bailouts, the Initiative may actually discourage the calling-in of existing debts, and generate the economists' "moral hazard" for the future: a preference for high risk/high interest rate loans, because the creditor gets to keep all of the gains and expects the state and international donors to bear most future losses (*see* Mandel & Foust, 1998). Also, the massive one-shot injection of fresh capital that Indonesia's banks expect may trigger a frenzy of lending activity which leads to history repeating itself: "more bad lending decisions" ("Macro", 1999, 25). In any event, it is the "hot money" from short-term creditors that gets bailed out; the equity and bond investors that are arguably more beneficial to Indonesia get left with the full consequences of their risk: *see* Mandel and Foust, 1998. Somewhat like India's Sick Industries Act (n. 5), the Jakarta Initiative may eventually create mixed and costly results from a reallocation of the incentives in Coasian games (*supra*).

*D.C. al Fine*



The reader probably saw the musical allusion in the “Theme and Variations” structure of this article. The resulting securitisation and bankruptcy “melodies” are harsh and discordant to Indonesian and foreign ears alike. While Indonesia is making brave attempts to solve individual (secured creditor) and collective action (bankruptcy) problems, creditors’ transaction costs and legal risks are much higher than they would be under more modern legal regimes. The outcomes under a more modernistic Jakarta Initiative remind us that even potentially inspired microeconomic solutions may not solve macroeconomic problems. Even ideal secured transactions and bankruptcy laws would be inadequate to a Crisis of Indonesian proportions: an \$80 billion private sector debt to be cleared (“Indonesia’s”, 1999). In the short run, the most we could expect from such laws is a marginal improvement in the creditors’ willingness to lend in Indonesia. But then many secured transactions, and the Indonesian corporate debtors that depend on them, live or die on the margin. (n. 6)

Beyond the immediate Crisis, the legal goal is developmental: broader, deeper, and more competitive debt finance markets. (n. 7) Such markets and laws would help keep enterprise failures from spawning market failures, and spawning an excessive wastage of the entrepreneurial talent that is scarce in all societies: *see* Kim, 1996. Just as an effective competition law reduces barriers to entering markets, an effective bankruptcy law reduces barriers to exiting markets, where exit is an unfortunate byproduct of effective markets: *see* Tomasic, 1999. The “infrastructure” for improved debt finance markets involves: better laws; better risk assessment, legal drafting, and monitoring by creditors; and more experienced judges (n. 8) and reorganization managers. To simply clear a company’s debt is often to leave it with the problems that bankrupted it in the first place. Reorganization is a scarce and valuable skill that can be taught, and international donors could facilitate this process for the benefit of all concerned.

According to Ross Cranston (1995,\_\_\_\_), a pro-debtor culture exists throughout Asia and, in Indonesia, this culture gets reflected in a solicitude towards debtors as ostensibly weaker parties. If true, this may explain some recent Commercial Court decisions, and it sets distinct limits to law reform processes seen to have a pro-creditor bias. “Social justice through law” is laudable, but it can mean that less money will be lent to Indonesian debtors at higher interest rates. In an ideal world, carefully coordinated bankruptcy, secured transactions, and crisis laws are implemented quickly and simultaneously. But a more realistic goal, of making creditors feel progressively more secure over time, is both worthwhile and attainable.

### ***End Notes***

1. If competing uses for funds, such as stock acquisitions or a direct investment, have lower risk/return ratios, relatively more capital will be provided in these ways and relatively less in the form of debt finance. While debt finance creditors are numerous in an ideal world, the Crisis and restructuring of banks in Indonesia mean that creditors will be fewer and mostly foreign for at least the next few years. Kapur (1999) explains as follows: a boom “activates the animal spirits of enterprise, profit expectations soar, and bankers, moving in herd-like patterns, overextend credit.” But come the Crisis and “the worst credit risks come forward to borrow aggressively..[while] bankers are reluctant to lend at all.” The “foreign investment community needs clear signs that Indonesia’s economy is once again moving forward”, through “bank recapitalization and corporate debt restructuring” (“Macro”, 1999, 21).

2. Transaction costs can and have been defined in many different ways. But they are best treated here as five costs of information, a scarce and valuable resource. *Search* costs are those of the creditor and debtor finding each other. *Negotiation* costs are those of finding the details of a bargain acceptable to both parties. *Monitoring* costs are those of determining whether the bargain is being kept. *Enforcement* costs are those of informing a judge, arbitrator, liquidator, etc. that the bargain was not kept, with a view toward obtaining a remedy. *Legal error* costs are those of rectification, and are social costs in the sense that their effects extend beyond the parties. (*Coordination* costs are discussed in the text, *infra*.) An efficient transaction is then one with the lowest *net* transaction costs. Some of the Indonesian Crisis can thus be explained as a creditors' reluctance to incur negotiation and especially monitoring costs. The economists' adage that there is no such thing as a free lunch is borne out by the fact that enforcement and especially legal error costs then escalated wildly out of control. The legal system proved wholly inadequate to the strains placed on it. This should have been obvious to creditors before the Crisis, and may have been discounted by charging higher interest rates, but high information costs within and about Indonesian law, as well as a wishful thinking, played significant roles.

3. This Law (S.1906-348, Annot.) applies to the "non Chinese Foreign East Class" [i.e., Dutch colonialists] only. The Orphans' Chamber opens the debtor's mail (1906, Art. 96); the debtor cannot leave his domicile without the Chamber's permission (1906, Art. 88); and the District Court can incarcerate the debtor for up to 90 days (1906, Art. 86). After bankruptcy, the debtor can file a petition for "rehabilitation", but only after all creditors have been paid in full (1906, Art. 205-06). Decisions on this petition are not subject to appeal (1906, Art. 210). Such provisions leave little hope for the revitalization of a business after bankruptcy, when compared to more modern bankruptcy laws from other jurisdictions.

4. This Draft may be changed by the drafters and/or Parliament, and is thus discussed in general terms only.

5. Under the 1985 Indian Sick Industrial (Companies Special Provisions) Act, a Board is given broad powers to determine whether a company can recover on its own, should be wound up, or rehabilitated through the Board's finance and moratorium on creditors' lawsuits. See Cranston, 1995, p. \_\_; Harmer, 1996, p. 2584. The expense of Board inefficiencies in creating some success stories in the textile industry is described by Roy, 1998.

6. Hong Kong does not have a secured transactions registry, Thailand has just created an uncertain bankruptcy process, and China and Thailand have corruption and legal uncertainties which are seemingly as great as Indonesia's: see Faison, 1999; "Thailand", 1999. Yet debt finance is returning to those countries and not to Indonesia. In the creditors' expected risk/return ratios, future political uncertainties in Indonesia loom large in essentially uncalculated ways. Rather than calculate these political uncertainties carefully, creditors apparently take refuge in the cheaper determination that capital should not be lent because of "legal uncertainties." By reducing these legal uncertainties, Government can help creditors see the high risk/high return opportunities that clearly exist in Indonesia.

7. The high transaction costs inherent in even an improved secured transactions/bankruptcy regime mean that this law would be unsuitable for the debt finance of small- and medium-sized enterprises in Indonesia. The debt finance market would likely continue to be fragmented, unless different laws are developed for SMEs. This is another topic, beyond the

scope of this paper. As Hissock (1999) puts it, a bankruptcy-style device is like divorce or a fire escape: commonly ignored, but something that the prudent require before they enter a transaction, marriage, or building.

8. Cranston (1995, 785-89) proposes four judicial reforms, to improve the secured transactions/bankruptcy regime: permitting “summary judgments”, quickly to dispose of unmeritorious cases which are mere stalling tactics; require the appellant to file a bond. deposit all of the judgment, or give the court a lien, to discourage frivolous appeals; require that the judgment debt run at a commercial rate of interest, from the date of inception; and administrative reforms which facilitate execution of security interests. He concludes (at 790) that: “The rhetoric of the rule of law is one weapon in the battle for fairer and more effective credit allocations.” See Rajagukguk (1999).

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